

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 BELGRADE 000188

SIPDIS

OC FOR 4232/ITA/MAC/EUR/OEERIS/SSAVICH

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [SR](#) [MW](#)

SUBJECT: GOS DECLARES IMF VICTORY, LOOKS TO PARIS CLUB

1. (U) SUMMARY: The GOS economic team jointly declared victory in completing the final review of its IMF program on February 6 and invited Paris Club action on implementing the final tranche of debt reduction before the next payment falls due. Finance Minister Dinkic also announced an ambitious plan to use the projected budget surplus of 2.6 percent of GDP for 2006 to cut employers' payroll contributions from 73 cents on the dollar to 60. The borrowing capacity released by the Paris Club debt reduction - and an expected reduction from Kosovo negotiations - should be used to borrow USD 800 million for road construction, primarily in Southern Serbia, Dinkic said. Serbia wants a follow-on IMF agreement, the finance minister asserted, but it must await the outcome of the Montenegro referendum. With Governor Jelasic seated to his right, Dinkic also defended the central bank against the recent scandal that has put the vice governor for the banking sector behind bars, and he proposed a purge of judges to fight corruption. end summary.

2. (U) Finance Minister Dinkic, National Bank of Serbia Governor Jelasic and Minister of Economy Bubalo made a joint presentation to the diplomatic corps on February 8 at which they painted a bright picture of Serbia's economic outlook. Dinkic noted that growth over the last two years, if the 2005 number comes in as expected, will have averaged 8 percent. The consolidated budget surplus should hit 2.6 percent for 2006, he said, largely on the basis of a cut in 40,000 public sector jobs (half in state-owned companies). And Serbia should capitalize on its budget surplus to cut payroll contributions for pensions, health and other items from 70 cents on the dollar to 63 cents, Dinkic argued, thereby making Serbia more attractive to foreign investors.

3. (U) Foreign direct investment in 2005 was USD 1.481 billion, up 53 percent over 2004 and Serbia's best year yet. Exports were the government's main task now, the finance minister said, and the increase of 29 percent for 2005 was largely driven by multinational companies, underlining the importance of FDI, he noted. The strong export performance also contributed to the sharp decline in the current account deficit, from 13.7 percent of GDP to about 9 percent in 2005.

4. (U) Another reflection of Serbia's brightening outlook is the rapid reduction in public debt, from 169 percent of GDP in 2000 to 44.5 percent in 2006, including the expected write-off of the last 15 percentage points of Paris Club debt. Dinkic pointed out that a further write-off of USD 1.1 billion related to Kosovo - a development he expects as part of upcoming status negotiations - will reduce public debt to 40 percent. Although that level still would mark Serbia as a country of medium indebtedness, Dinkic said, public finances would be strong enough to support an additional USD 800 million in borrowing to finance the completion of four-lane highways in Corridor 10 of Southern Serbia. And Serbia's improved financial status was recognized this week by the World Bank's decision to make Serbia eligible for standard Bank lending. (Note: Serbia no longer qualifies for concessional lending from the World Bank.) Dinkic also called on the OECD to reassess Serbia's credit rating.

5. (U) Inflation remains the dark cloud on Serbia's economic horizon. Dinkic said that a tight incomes policy would help to bring inflation down to single digits in 2006, from 17.7 percent in 2005, although many analysts believe this will be difficult. The finance minister turned over the discussion to Jelasic, who had been his deputy when Dinkic was central bank governor.

6. (U) Jelasic immediately reminded the audience that the IMF prescription for curbing inflation includes faster restructuring of the economy, to improve its supply response, as well as fiscal and monetary restraint. Bringing inflation down to single digits would not be easy, he said. However, the governor returned to the good news theme by announcing that the National Bank's official reserves have reached USD 6 billion, enough to cover six months of imports. The exchange rate has been stable. (Note: One questioner observed that dinar actually appreciated against the Euro in 2005.)

7. (U) The NBS governor cited, with relish, the dramatic increase in savings, from EURO 1.4 billion at end-2004 to EURO 2.2 billion in 2005. This, in turn, had allowed a rapid increase in lending based on domestic funding, as opposed to external sources. Lending was up 65 percent in 2005, to EUR

5.3 billion. (Note: Almost all savings and lending are in Euro, an issue highlighted by the IMF's sixth review report, which pointed to the growing foreign exchange risk in bank lending to companies and consumers that earn in dinar.)

18. (U)The discussion turned interesting as diplomats questioned the Serbian economic team. Dinkic said that Serbia wants a one-year precautionary IMF arrangement, in part to drive further reform. However, he said Montenegro was against any new deal before the independence referendum, so talks must wait. (Note: Jelasic did not address this issue at the presentation, but he has been more forward-leaning, urging Serbia to at least start talks with the IMF now, in part because rating agencies expect a new agreement.)

19. (U)A Finnish official queried Dinkic on corruption, and the finance minister used the opportunity to defend the central bank in the recent scandal involving a sting operation that put the vice governor for banking regulation behind bars. He accused Israeli investors who bought a borderline Serbian bank of using "big pressure" - the corruption scandal - when the central bank withdrew the bank's license. But the pressure would not work, Dinkic said, because it was simply not possible for the National Bank to reverse such a regulatory action. (Note: A lawyer for the Israeli investors has claimed that Jelasic solicited a Euro 2 million bribe to restore the bank's license, leading to the sting that snared the vice governor.)

10. (U)The government campaign against Milosevic-era tycoon Bogoljub Karic should be seen as an attempt to make all equal before the law, Dinkic said. And corruption pervades the courts, Dinkic said, which are independent of the government but not independent of certain businessmen. (Dinkic did not refer explicitly to the courts' repeated decisions in favor of Karic's Astra Banka when the National Bank had revoked its license.) The finance minister said he would propose to the government that all judges be "re-elected," allowing the removal of those found to be unacceptable.

Moore